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UNCLAS SECTION 01 OF 02 YEREVAN 002407

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E.O. 12958: N/A

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SUBJECT: ARMENIA'S STEADY GROWTH, STABLE ECONOMY:
WINNING THE GAME OF INCHES

1. (U) This cable is sensitive but unclassified. Please protect accordingly.

SUMMARY

2. (SBU) Armenia's 2004 economic performance should lend confidence to investors and development economists alike. Armenia's oft-cited problems notwithstanding, the economy continues to grow, driven largely by private investment across several sectors. All indicators suggest a stable macroeconomic environment and steady (but slow) progress reducing poverty. End Summary.

MACROECONOMIC OVERVIEW: GROWTH REMAINS STRONG

3. (SBU) GDP growth remained strong at 9.7 percent during the first three quarters of 2004, vice 14.8 percent for the same period last year. The government's estimate of a year-end growth rate of 8 percent is likely to be right: growth in the fourth quarter is typically slower than the year average. By sector, growth was strongest in construction, retail trade and agriculture. A decline in the diamond polishing industry due to reduced imports of raw diamonds from Russia accounts for a fall in industrial growth to 2.8 percent from 27 percent last year as well as a similar fall in Armenia's export and import numbers. Non-diamond industrial growth was 9 percent, in line with overall growth in GDP.

PRIVATE CONSTRUCTION THRIVING

4. (SBU) As in 2002 and 2003, construction is one of the key growth sectors. The continuing growth in the construction industry has proven wrong the popular assertion that last year's construction boom depended wholly on the Lincy Foundation's humanitarian financing of USD 115 million of improvements in 2002 and 2003. Construction is up 18 percent on last year's level, which includes the Lincy Foundation's contributions, and 60 percent of all construction is privately financed. In addition to providing a good source of employment to unskilled workers, Yerevan's ongoing construction boom (largely housing) bears witness to the rising level of local investor confidence.

INFLATION AND EXCHANGE RATES STEADY

5. (SBU) Despite concerns about inflation earlier in the year, the government is likely to meet its three percent inflation target. In August 2004 the Central Bank allowed the dram to appreciate against foreign currencies making many imports cheaper. Controlled annual inflation and the relative stability of Armenia's currency create a stable environment for business. The dram's sudden adjustment against the dollar this year appears to be sticking: we do not expect volatility in the currency market.

CASH POVERTY PERSISTS DESPITE SLIGHT IMPROVEMENTS

6. (SBU) Despite several years of high growth, commensurate improvements in poverty levels have been less evident. In October the GOAM statistics service announced the first significant drop in the poverty rate in several years, to 42.9 percent from 49.7 percent of the population. Although the official poverty line (about USD 24 per month) is probably too low to reflect the cost of living, lower-income Armenians are "cash poor." People generally have shelter and clothing and even old luxury items like a

television, but they lack income beyond meager pensions or cash remittances from relatives living abroad. In rural areas there are more serious poverty issues related to access to water and electricity.

LOWER INTEREST RATES A POSITIVE SIGN

17. (SBU) No sign is more important to Armenia's investors than the steady fall in lending and deposit rates in the banking sector. Government treasury bond yields have fallen to under 7 percent, illustrating a perception of lower country risk and allowing commercial banks to attract deposits more cheaply. Although bank lending rates remain prohibitively high at 18 percent, the sharp fall in deposit rates from 18 percent in 2001 to 4.8 percent today suggests that banks will be able to lend money more cheaply in the future. Armenia's banking sector is still a woefully inadequate source of capital and people depend on friends and family to finance investments. Nevertheless, government measures designed to strengthen the banking sector have done so and interest rates are market-determined.

COMMENT: WINNING THE GAME OF INCHES

18. (SBU) While Armenia's critics rightly disparage what appears to be worsening corruption and further consolidation of wealth into the hands of a few oligarchs, statistics continue to suggest that Armenia is winning the game of inches. As Armenia's economy continues on its path of strong growth, the overall macroeconomic environment remains stable and there are noticeable positive effects on poverty. The government has had small success in raising its tax revenues by 18 percent, which should help it meet its targets to reduce poverty among those populations that depend on government salaries and pensions. The constantly improving situation explains the public's general acquiescence to Armenia's oligopolistic economy: the course of Armenia's development and the distribution of its wealth may not be fair, but inch by inch the situation is improving for most people.
EVANS